Internal Revenue Service

memorandum

CC:TL:Br3
MNelson

date: FEB 8 1988

to: District Counsel, Brooklyn NA:BRK

from: Chief, Branch No. 3, Tax Litigation Division CC:TL

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subject: Request for Technical Advice
[redacted]
Docket No. [redacted]

This responds to your request for technical advice in the case referenced above. The request seeks advice on answering the petitioner's arguments that cash found in his possession cannot be deemed to be his income because it was forfeited to the federal government under a statute that vests title to the cash with the government at the moment the income-generating crime was committed.

FACTS

[redacted]'s [redacted] tax year was terminated by the Service for the period [redacted], through [redacted], after a lawful search of his residence on [redacted], resulted in the discovery of approximately $[redacted] in cash, a gun, controlled substances, and jewelry. These assets were forfeited to the U.S. government pursuant to the civil forfeiture provisions of 18 U.S.C. section 881. On [redacted], the Service issued a statutory notice that determined a deficiency of $[redacted] (the amount of the termination assessment), plus additions to tax pursuant to sections 6651(a), 6653(a)(1), and 6653(a)(2). The amount of the deficiency was calculated by reference to the amount of cash seized, increased by an estimated cost of living, less an allowance for one personal exemption, plus self-employment taxes.

LEGAL ANALYSIS

The crux of petitioner's argument is that, under 18 U.S.C. section 881, he never owned the money, therefore, it cannot be his income. Ownership of assets is not a prerequisite to taxability, however; it is only necessary that the petitioner exerted dominion and control over the assets sufficient to derive economic benefit from the assets. Commissioner v. Glenshaw Glass Co., 348 U.S. 426(1955); James v. United States, 366 U.S. 213 (1961). We do not know the extent to which the petitioner exercised his dominion and control beyond the fact of possession. Although such a fact may be sufficient, we suggest that you ascertain whether the petitioner contested the forfeiture or whether his criminal trial yielded any evidence related to petitioner's acquisition or control of the forfeited assets and use this information to support a proposed finding of fact that will allow the Tax Court to hold that the forfeited amounts are taxable to [redacted].

The propriety of including forfeited amounts in a taxpayer's gross income was addressed, at least indirectly, by the Tax Court in Schad v. Commissioner, 87 T.C. 609 (1986), aff'd, 827 F.2d 774 (11th Cir. 1987). In Schad, the petitioner was the transferee of $300,000 from a deceased drug dealer and was arrested in possession of $174,679, which was forfeited to the State. The Service issued a notice of transferee liability to the extent of the $300,000 for the taxes of the deceased transferor and also determined deficiencies in the petitioner's taxes based in part on the inclusion of the forfeited $174,679 in the petitioner's income. The taxpayer claimed that the $174,679 was part of the $300,000, thus it was not his income, and that he should not be liable as transferee, at least at to $174,679, because that amount was forfeited to the government.

The Tax Court was not convinced that the cash found with the petitioner was the decedent's money and held that the petitioner was not entitled to reduce his transferee liability by the amounts forfeited. Although the Court did not expressly address whether forfeited amounts could be included in gross income, the Court upheld the Service's deficiency determination and acknowledged that the petitioner was being "subjected to transferee liability, taxation, and forfeiture for the same amount." 87 T.C. 609, 623 (1986) (footnote omitted).

The Court also noted that a deduction is not allowable for property forfeited in connection with illegal activities, citing Holmes Enterprises, Inc. v. Commissioner, 69 T.C. 114 (1977); and Holt v. Commissioner, 69 T.C. 75 (1977), aff'd per curiam, 611 F.2d 1160 (9th Cir. 1980).

It may seem harsh to include forfeited amounts in a taxpayer's gross income without allowing a deduction for the forfeiture, but the harshness of this result is consistent with the attack on the economic benefits of crime that is the raison d'etre of the forfeiture provisions contained in the U.S. Code. See, CONTINUING APPROPRIATIONS, 1985 - COMPREHENSIVE CRIME CONTROL ACT OF 1984, H. REP. NO. 98-1030, 98th Cong., 2d Sess., reprinted in November 1984 U.S. CODE CONG. & ADMIN. NEWS 1984 (1984), a copy of which is attached for your convenience. We are also attaching a copy of respondent's brief in Pring v. Commissioner, Docket No. 11452-85, in which this issue is addressed, so that you can see examples of proposed findings of fact that will be helpful in winning this case. Please pay particular attention to proposed findings number 5, 6, and 9, which, if adopted by the Court, will support a finding that the taxpayer exercised dominion and control over the assets. In addition, the following cases involve termination assessments in which at least part of the taxes were based on cash forfeited to the government. Randall v. Unites States 82-1 U.S.T.C. Par. 9356 (D. Minn. 1982); Gonzalez v. United States, 606 F.Supp 134 (S.D. Fla. 1985).

We trust that the foregoing is responsive to your request. Please do not hesitate to let us know if we may be of further assistance.

DANIEL J. WILES

Attachments: As stated.